

STRICTLY CONFIDENTIAL (FR) CLASS I-FOMC

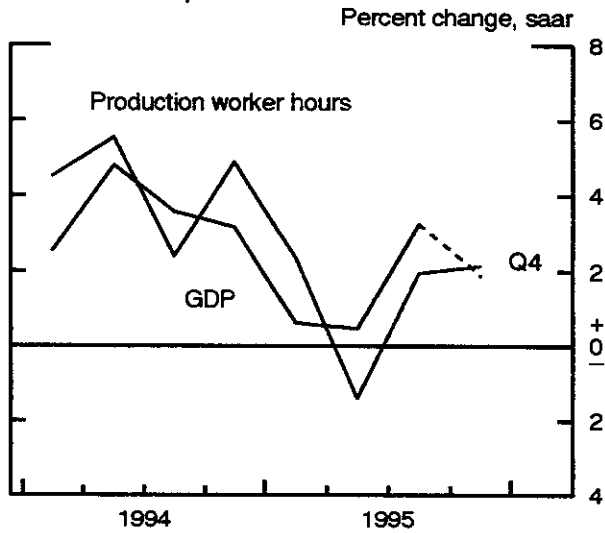
Material for
Staff Presentation to the
Federal Open Market Committee

January 30, 1996

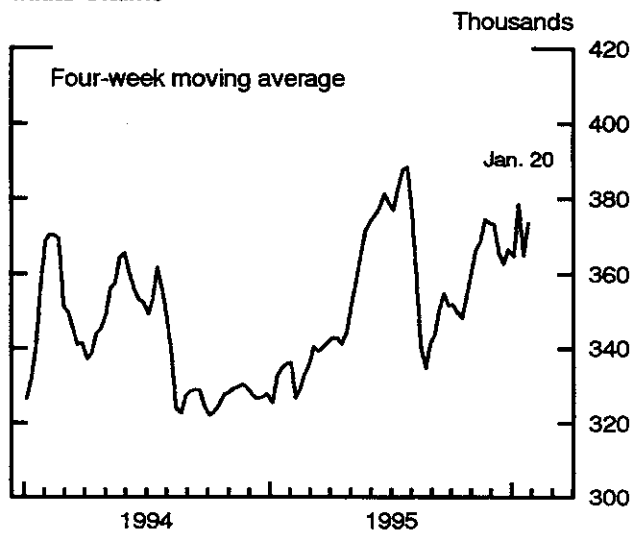
Chart 1

Recent Indicators

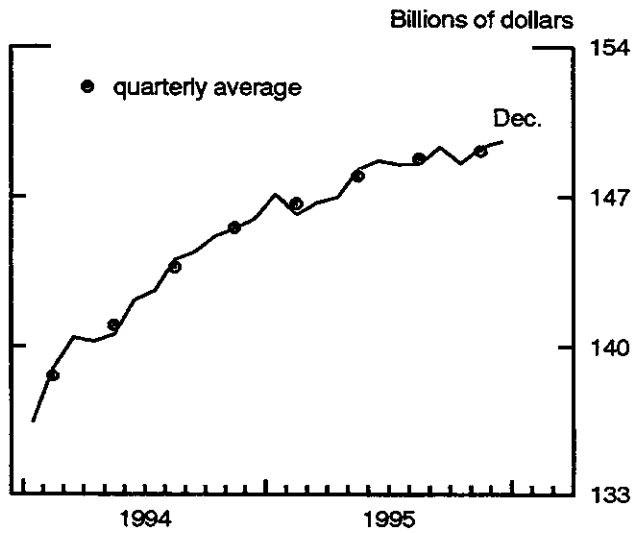
Hours and Output Growth



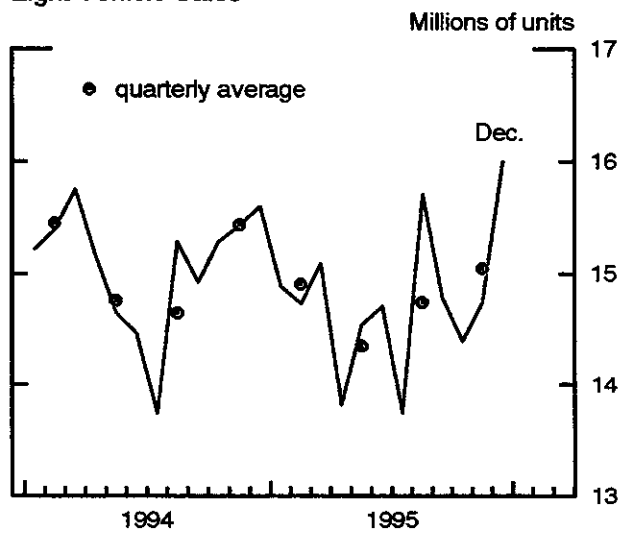
Initial Claims



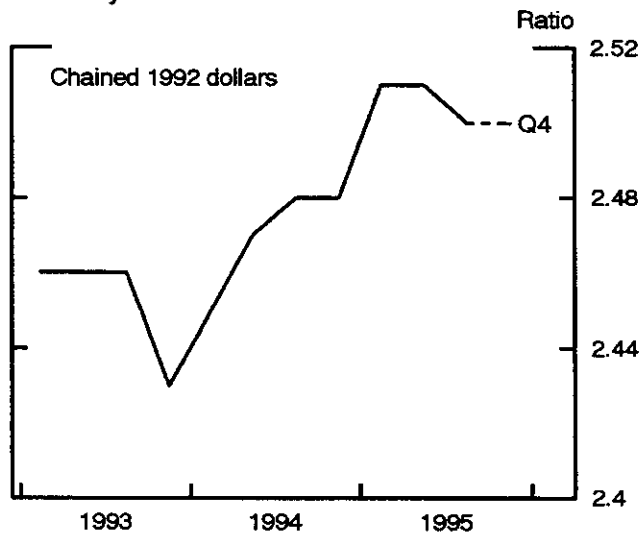
Retail Sales Ex. Autos



Light Vehicle Sales



Inventory-Sales Ratio



Manufacturing Orders

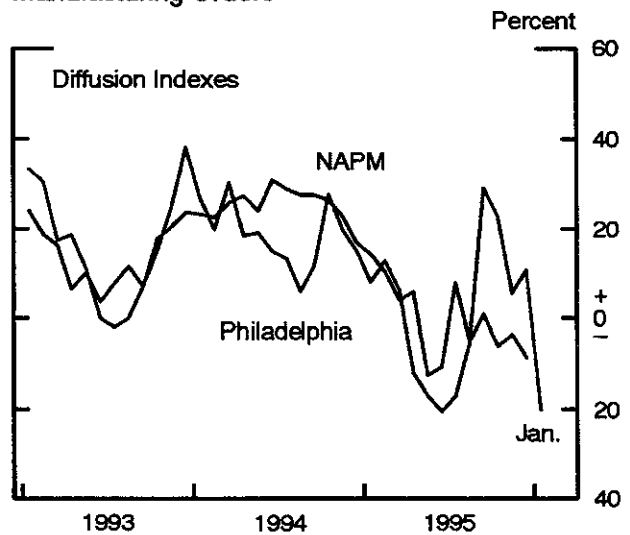
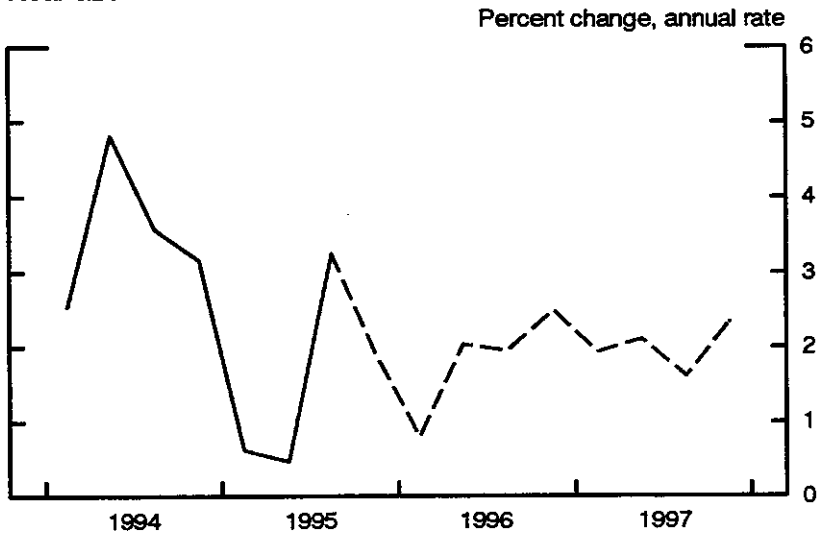


Chart 2

Forecast Summary

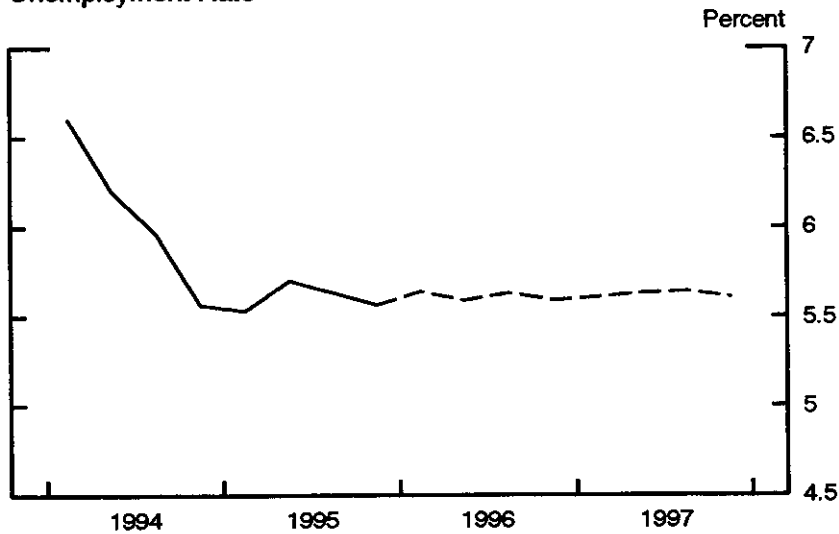
Real GDP



Q4/Q4 Percent Change

| | |
|------|-----|
| 1994 | 3.5 |
| 1995 | 1.5 |
| 1996 | 1.8 |
| 1997 | 2.0 |

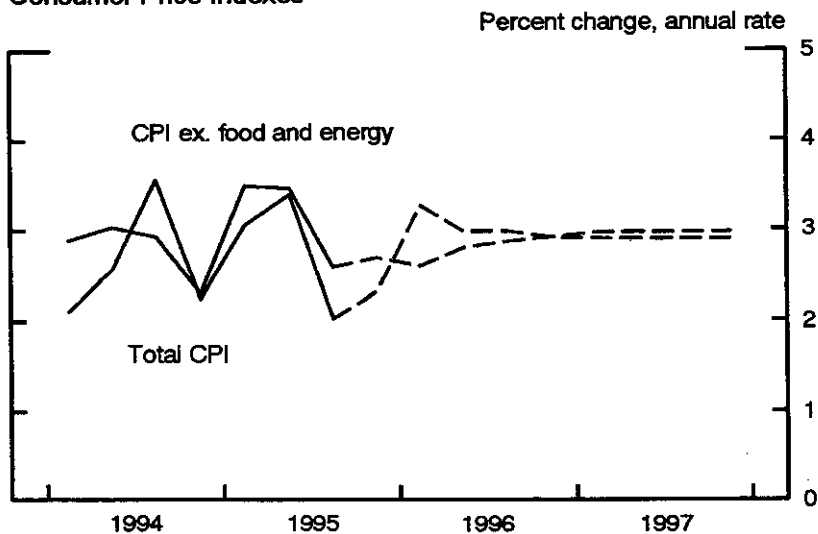
Unemployment Rate



Q4 Average

| | |
|------|-----|
| 1994 | 5.6 |
| 1995 | 5.6 |
| 1996 | 5.6 |
| 1997 | 5.6 |

Consumer Price Indexes

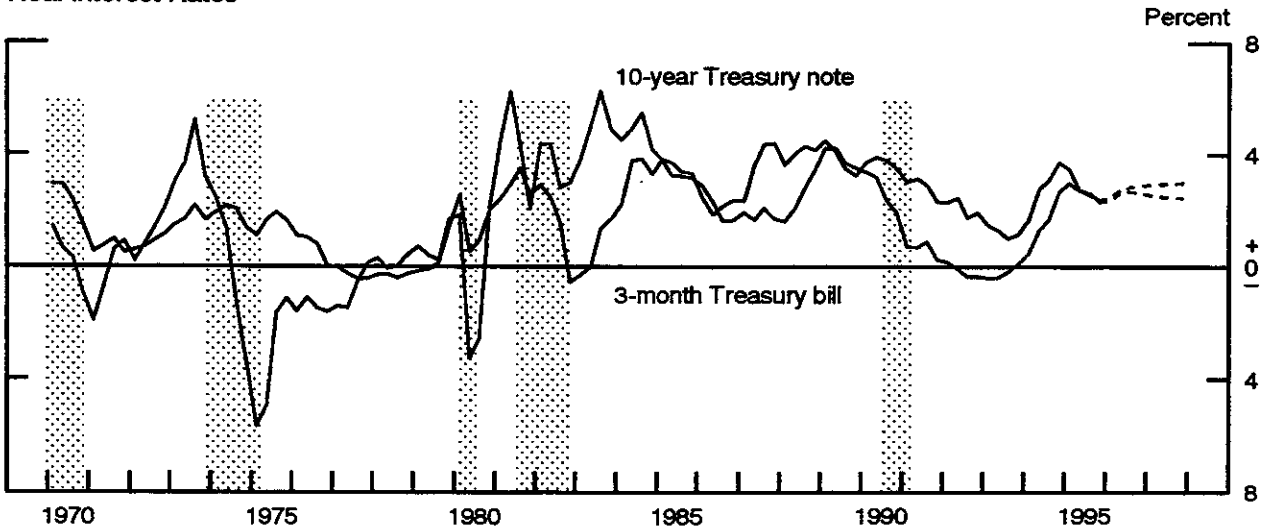


Q4/Q4 Percent Change

| | CPI | CPIX |
|------|-----|------|
| 1994 | 2.6 | 2.8 |
| 1995 | 2.7 | 3.1 |
| 1996 | 3.0 | 2.8 |
| 1997 | 2.9 | 3.0 |

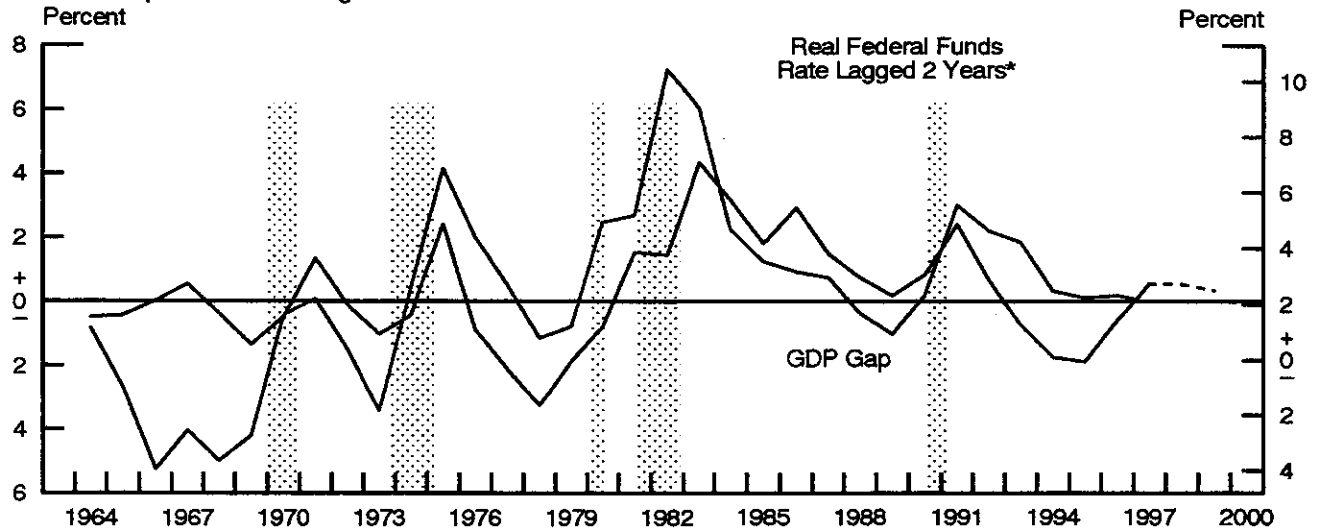
Financial Market Conditions

Real Interest Rates*



* Inflation expectation based on prior 1-year and 5-year core CPI changes for 3-month and 10-year Treasury rates, respectively.

GDP Gap and 2-Year Lag of Real Funds Rate



* The nominal funds rate is deflated by Q4-to-Q4 core CPI inflation, using (before 1982) the experimental series that treats owner's equivalent rent consistently throughout history.

Bank Business Lending Policies

| Distribution of Bank Assets By Capital Status* | | |
|---|---------|---------|
| (Percent of industry assets) | | |
| | 1990:Q4 | 1995:Q3 |
| Under Capitalized | 31.3 | 0.5 |
| Adequately Capitalized | 38.6 | 2.9 |
| Well Capitalized | 30.1 | 96.6 |

*Adjusted for examiner ratings.

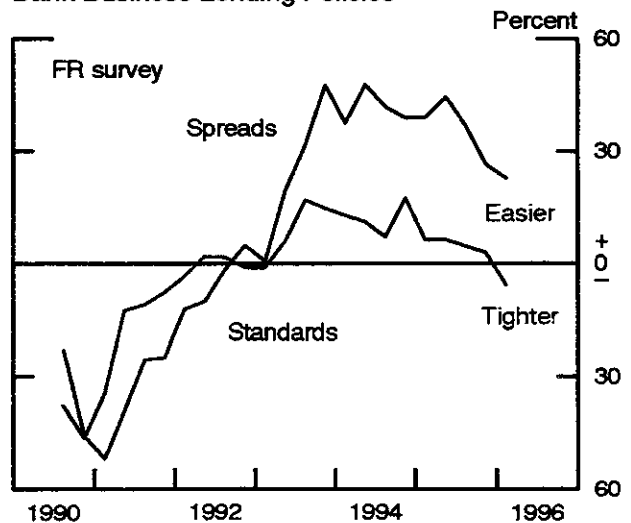


Chart 4

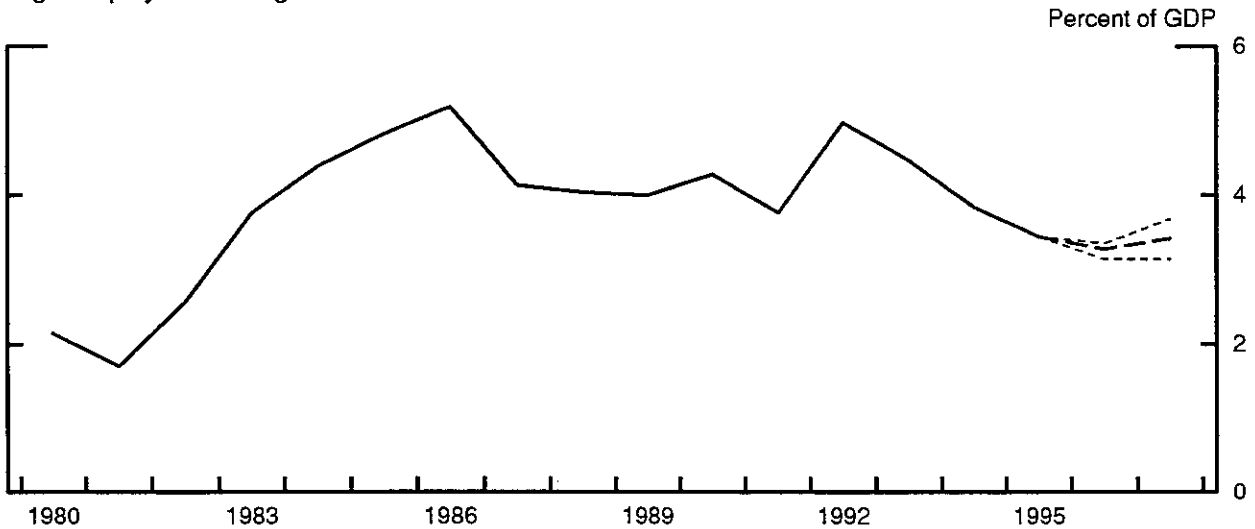
Fiscal Policy Outlook

Fiscal Assumptions - Billions of Dollars of Deficit Reduction, Relative to OBRA-93 Path

| | December Greenbook FY 1996 | FY 1997 | January Greenbook FY 1996 | FY 1997 | "Downpayment"?? FY 1996 | FY 1997 |
|---------------|-------------------------------|---------|------------------------------|---------|----------------------------|---------|
| Total* | -25 | -31 | -21 | -19 | -18 | +2 |
| Discretionary | -17 | -28 | -21 | -19 | -21 | -19 |
| Mandatory | -7 | -22 | 0 | 0 | -1 | -4 |
| Taxes | -1 | +19 | 0 | 0 | +4 | +25 |

* Excluding interest savings.

High Employment Budget Deficit



Fiscal Impetus

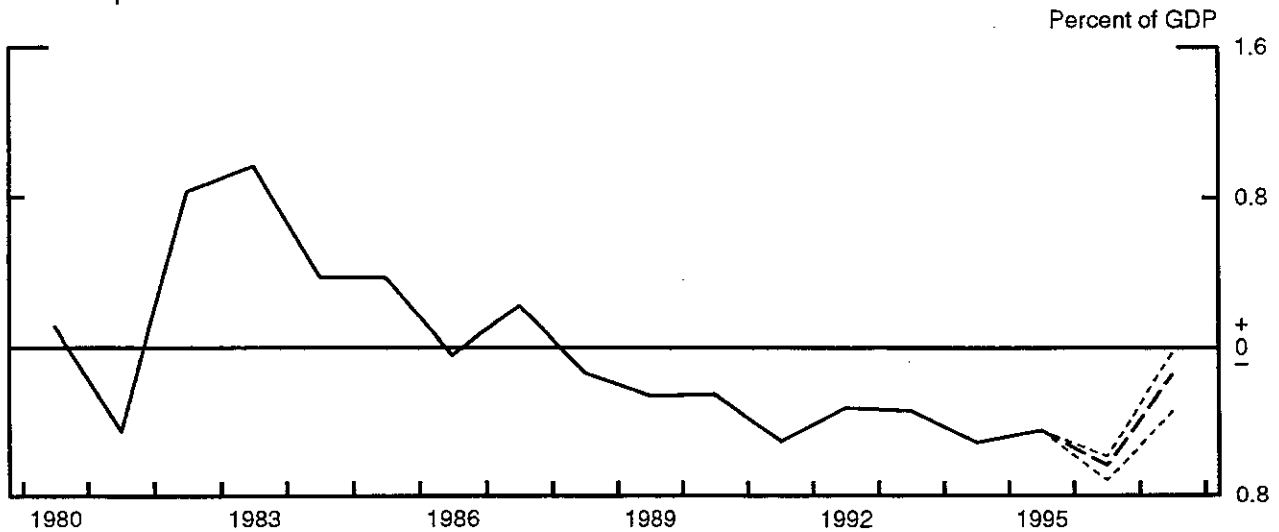
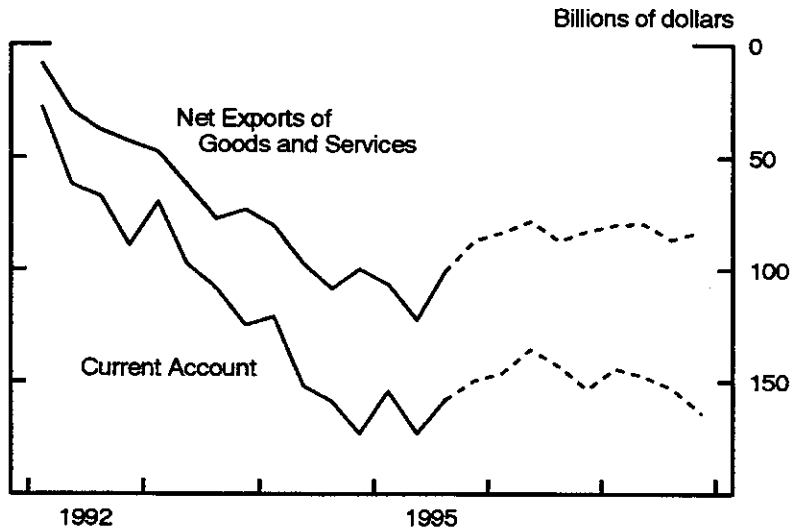


Chart 5

Summary of the Outlook: External Sector

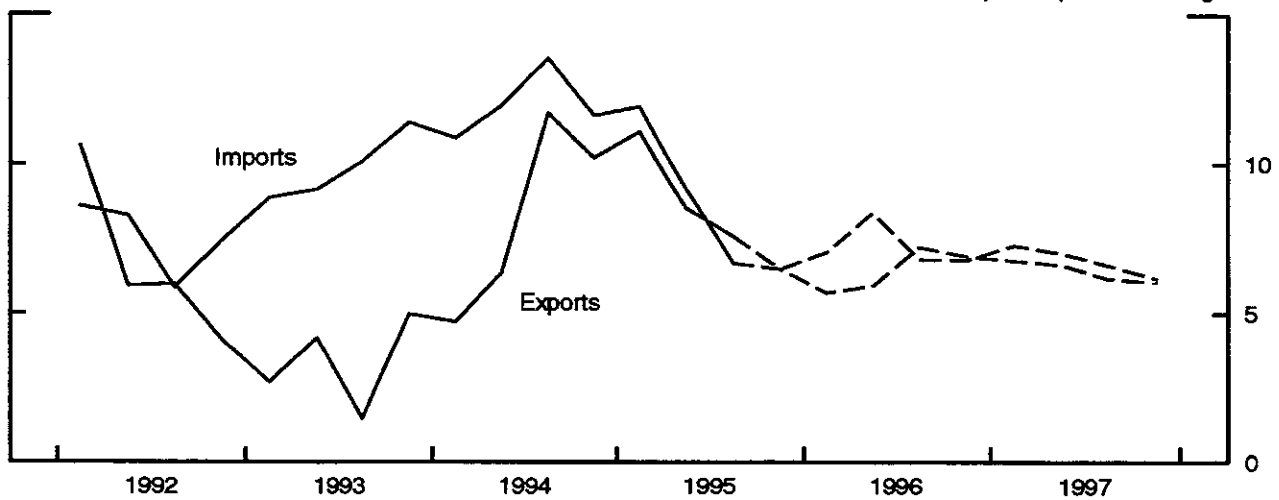
External Balance



Current Account

| | Percent of GDP |
|------|----------------|
| 1985 | -3.0 |
| 1986 | -3.4 |
| 1987 | -3.5 |
| 1992 | -1.0 |
| 1993 | -1.5 |
| 1994 | -2.2 |
| 1995 | -2.2 |
| 1996 | -1.9 |
| 1997 | -1.9 |

U.S. Exports and Imports of Goods and Services
(Chained 1992 dollars)



Contribution of Net Exports to U.S. Growth
(Chained 1992 dollars)

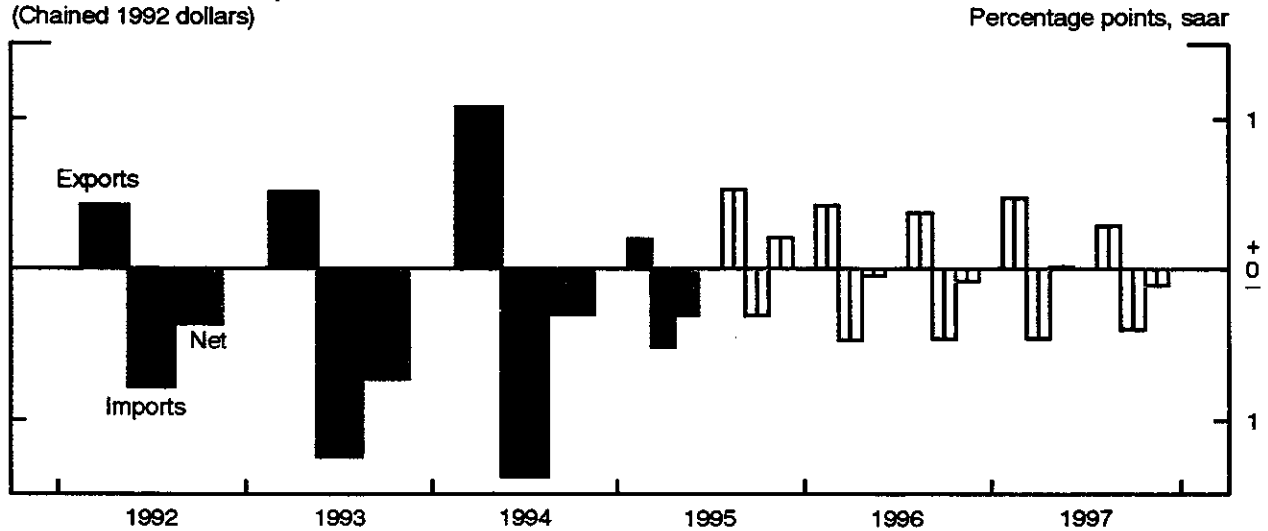
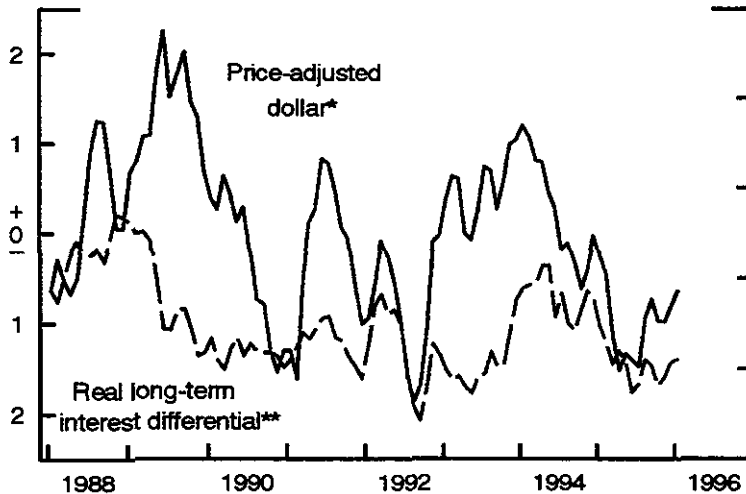


Chart 6

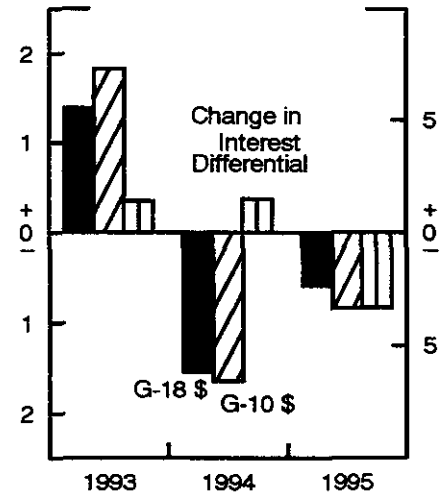
Exchange Rates

Dollar and Interest Differential
Percentage points

Index, March 1973 = 100



Percent change, Q4 to Q4

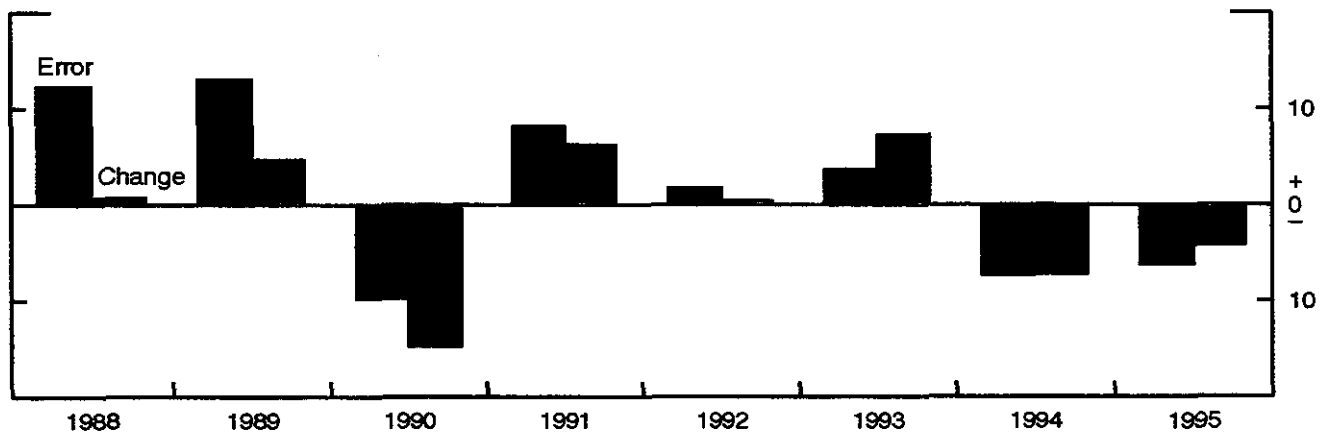


* Weighted average against foreign G-10 countries, adjusted by relative consumer prices.

** Difference between rates on long-term U.S. 10-year government bond and a weighted average of foreign G-10 benchmark government bonds, adjusted for expected inflation.

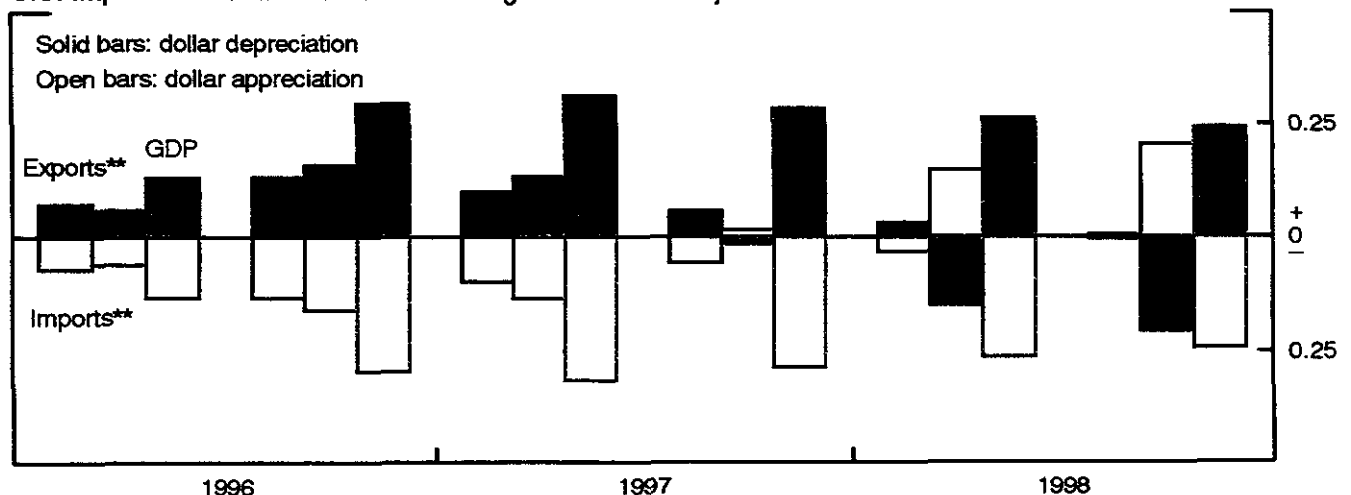
Projection Error and Actual Change in the Price-Adjusted G-10 Dollar*

Percent change, Q4 to Q4



*Error is difference between actual change and forecast made one year earlier.

U.S. Implications of a Four Percent Change in the Price-Adjusted Dollar* Percent change from baseline GDP



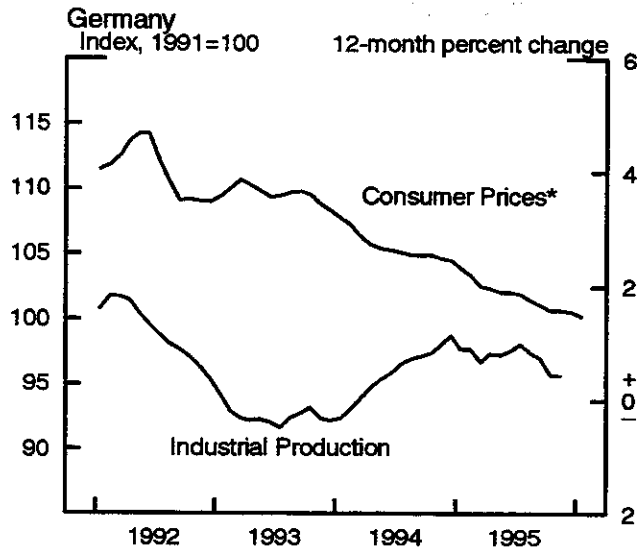
* Change is phased in over four quarters of 1996 and held at new level for 1997 and 1998.

** Change in percent contribution to GDP

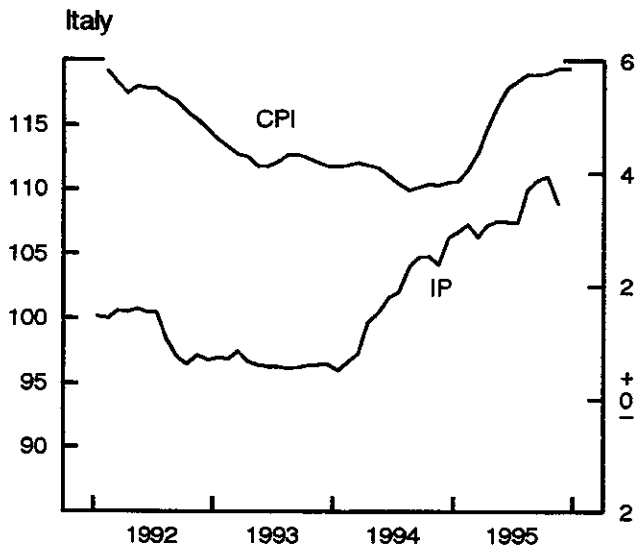
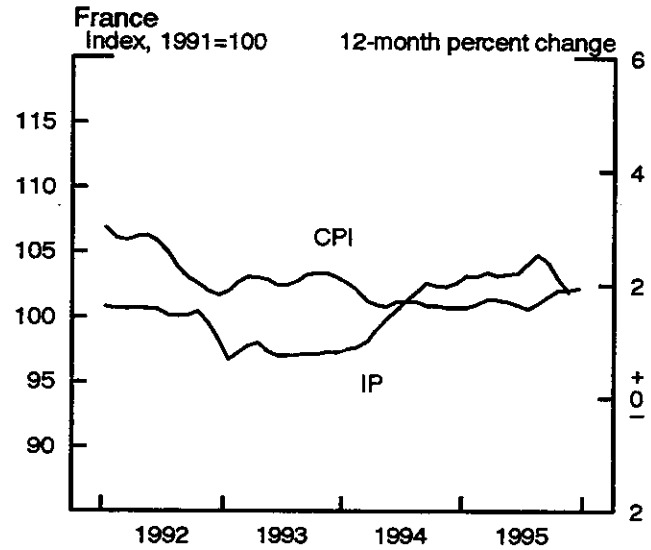
Chart 7

Foreign Industrial Production and Consumer Prices

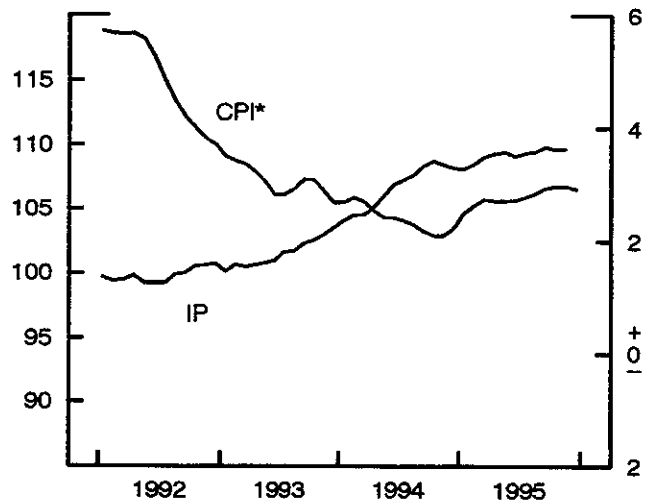
(3-month moving averages)



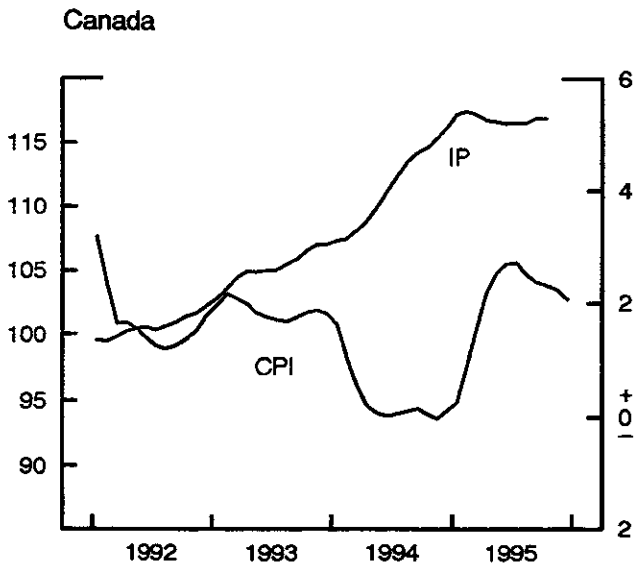
* West Germany



United Kingdom



*Excludes mortgage interest payments.



Japan

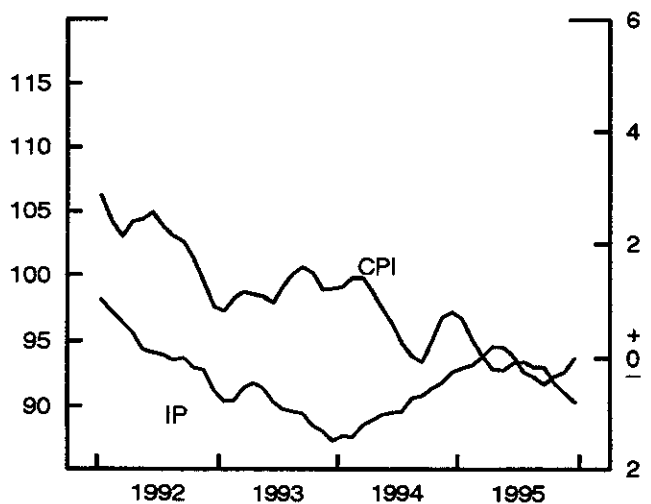


Chart 8

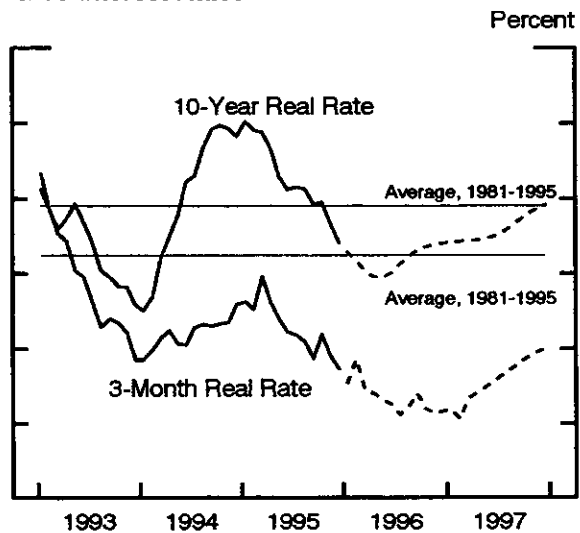
Foreign Outlook

Fiscal Policy*

| | Change 1994 & 1995 | Change 1996 & 1997 |
|----------------|-----------------------|-----------------------|
| Germany | ½ | 1 |
| France | 0 | 1¾ |
| Italy | 1½ | 2½ |
| United Kingdom | 1½ | 2¼ |
| Canada | 1½ | 2¾ |
| Japan | -1¼ | ¼ |

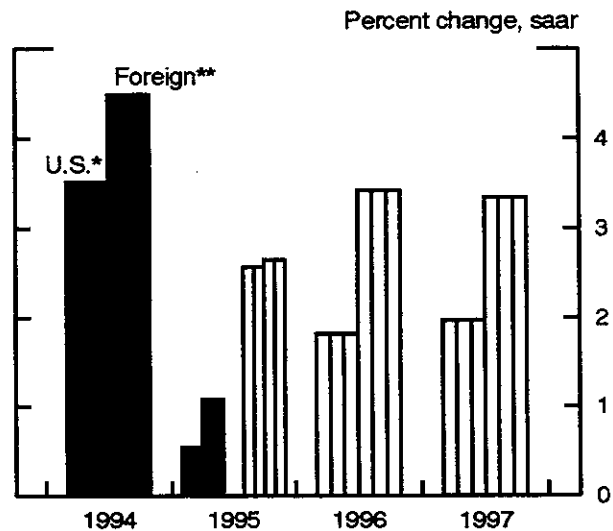
* Change in structural government budget balances percent of GDP calendar year basis

G-10 Interest Rates



Real GDP

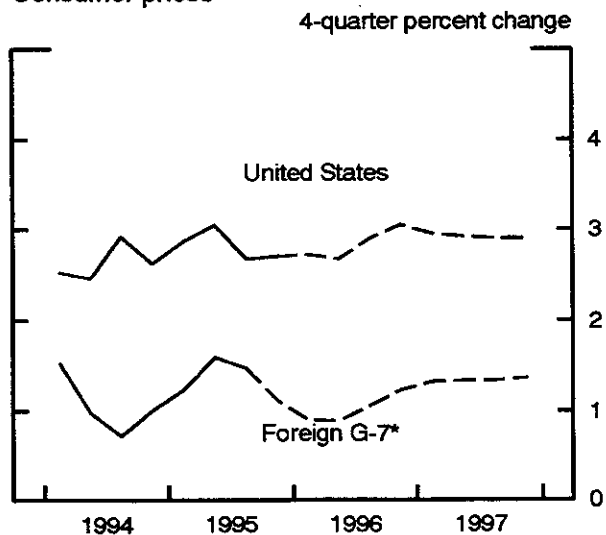
| | Percent change, Q4 to Q4 | | |
|-----------------|--------------------------|------|------|
| | 1995 | 1996 | 1997 |
| Europe (G-7) | 1.5 | 2.3 | 2.5 |
| Japan | 1.4 | 3.1 | 2.3 |
| Canada | 0.9 | 2.4 | 2.3 |
| Mexico | -9.5 | 4.3 | 5.5 |
| Other Latin Am. | 2.9 | 2.5 | 3.0 |
| Other Asia | 7.5 | 6.7 | 6.7 |



* Chained 1992 dollars

** U.S. nonagricultural merchandise export weights.

Consumer prices



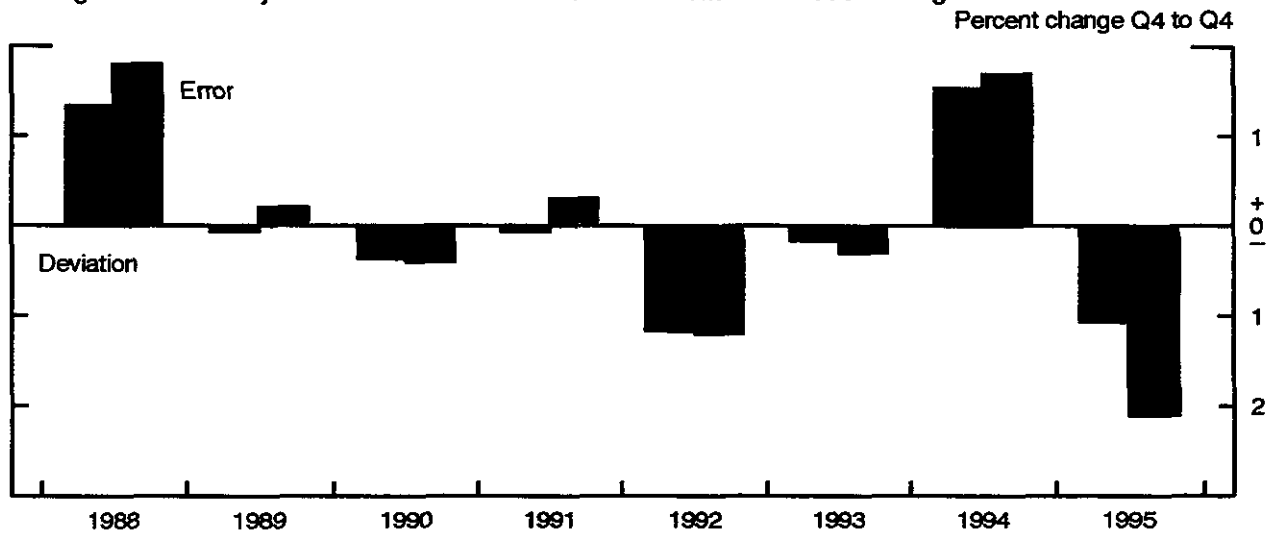
*U.S. non-oil import weights.

| | Percent change, Q4 to Q4 | | |
|----------------|--------------------------|------------|------------|
| | 1995 | 1996 | 1997 |
| W. Germany | 1.5 | 1.9 | 2.0 |
| France | 1.9 | 1.8 | 1.8 |
| Italy | 5.9 | 4.4 | 4.0 |
| U.K.* | 2.9 | 2.8 | 3.0 |
| Canada | 2.1 | 1.6 | 2.0 |
| Japan | -0.8 | 0.0 | 0.0 |
| Average | 1.1 | 1.2 | 1.4 |

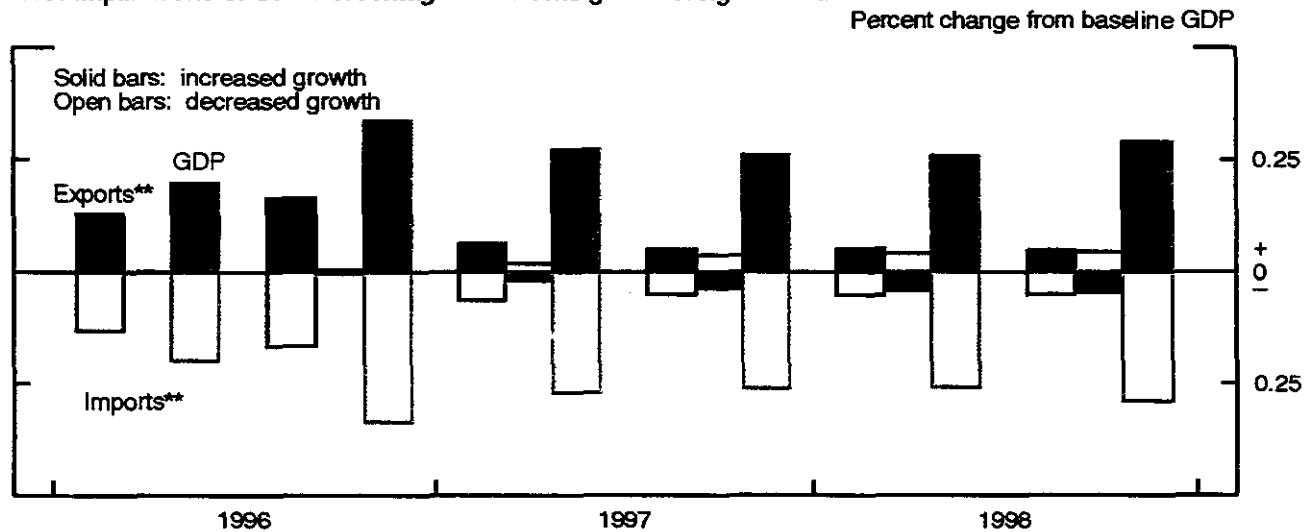
* Excludes mortgage interest payments.

Risks to the Forecast

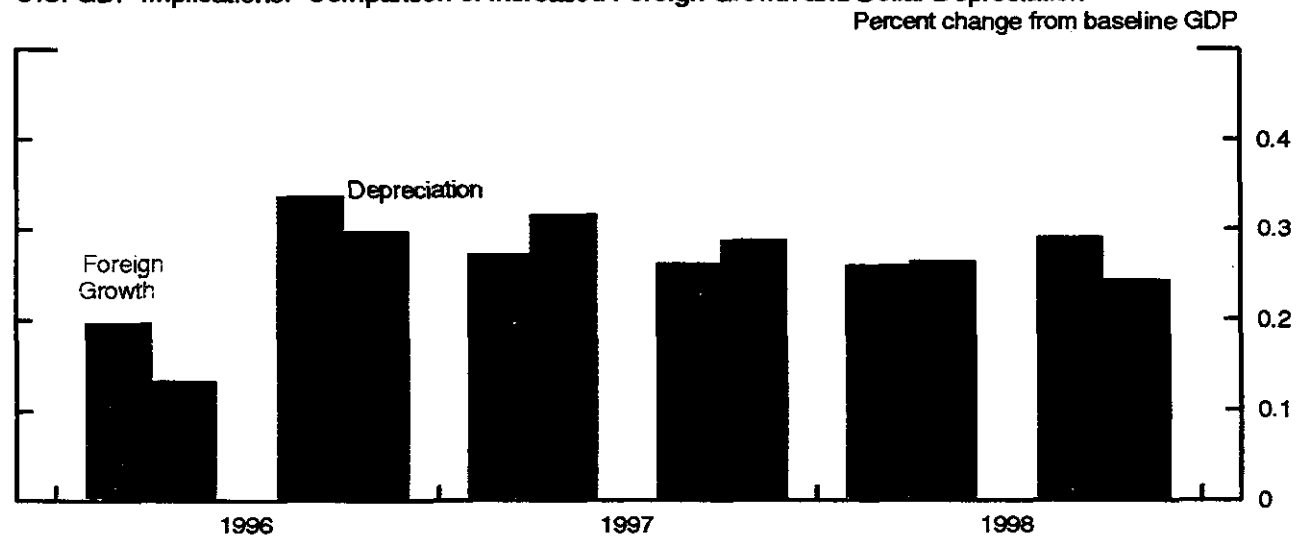
Foreign Growth: Projection Error and Actual Deviation from 1988-1995 Average*



U.S. Implications of One Percentage Point Change in Foreign Growth*



U.S. GDP Implications: Comparison of Increased Foreign Growth and Dollar Depreciation



External Pressures on Short-Term Interest Rates

Baseline:

Greenbook forecast extended to 2002

Monetary Policy Assumptions:

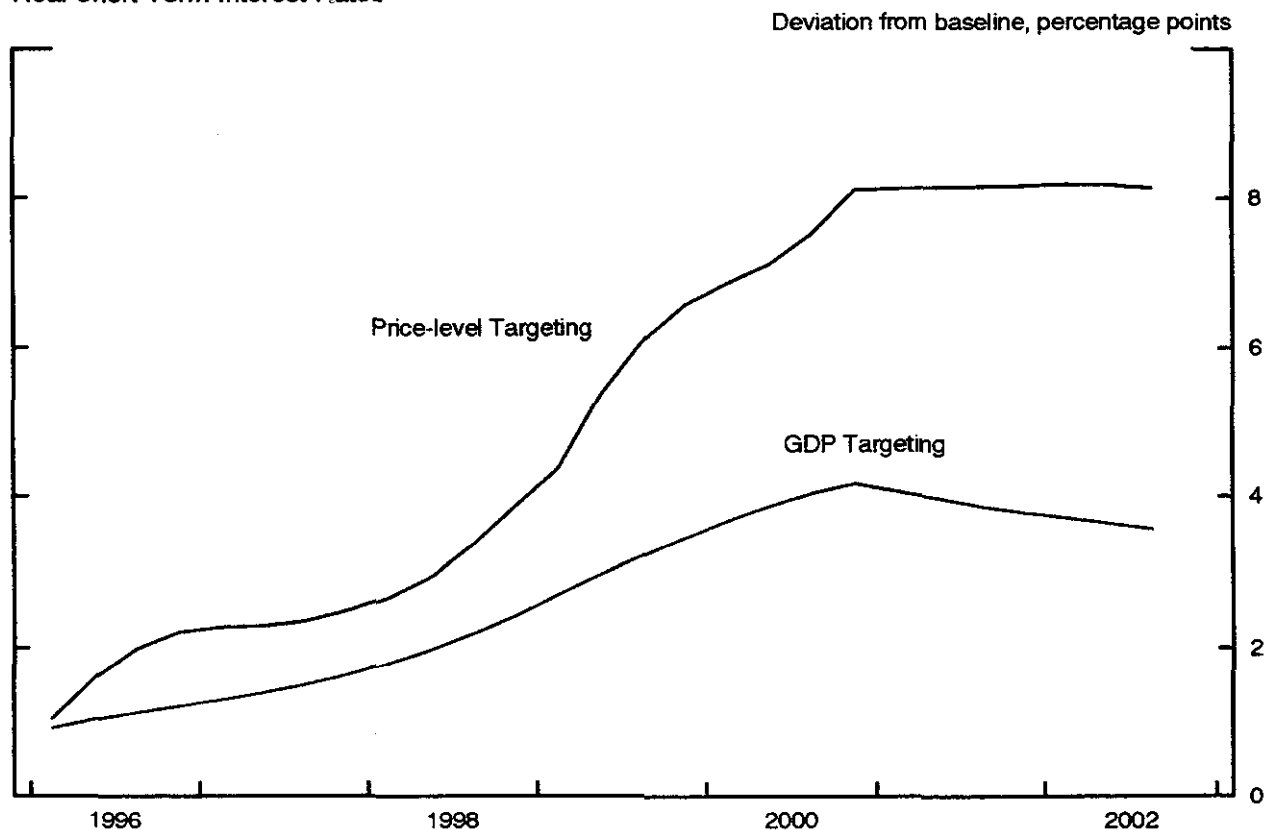
(a) Real GDP held close to baseline

(b) Price level held close to baseline

Alternative Scenario:

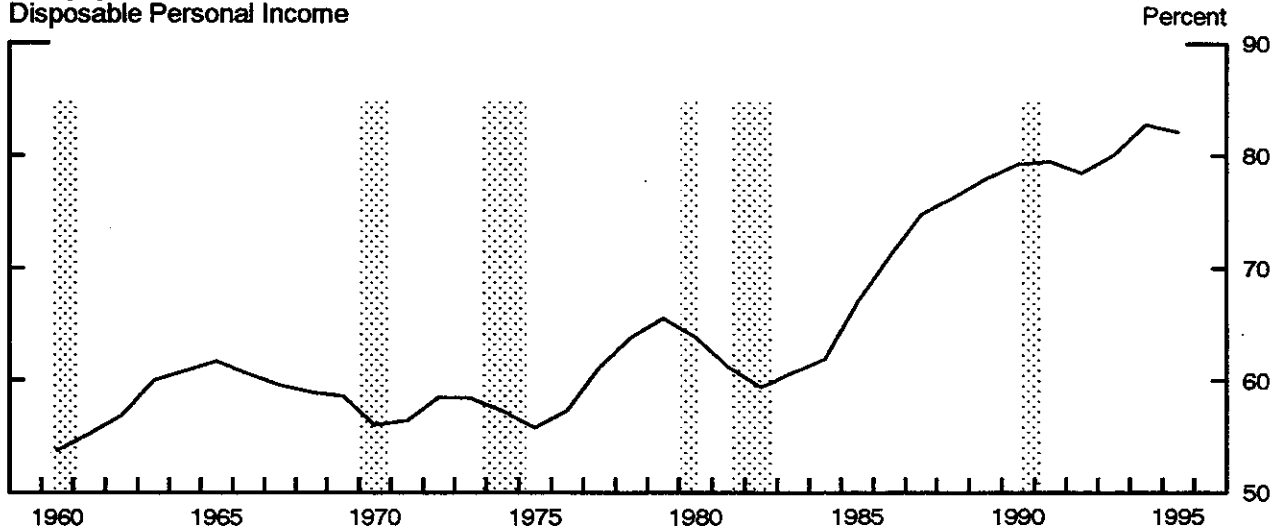
Dollar depreciates during 1996-2000 by an amount sufficient to narrow the U.S. current account deficit by 2 percent of GDP

Real Short-Term Interest Rates*

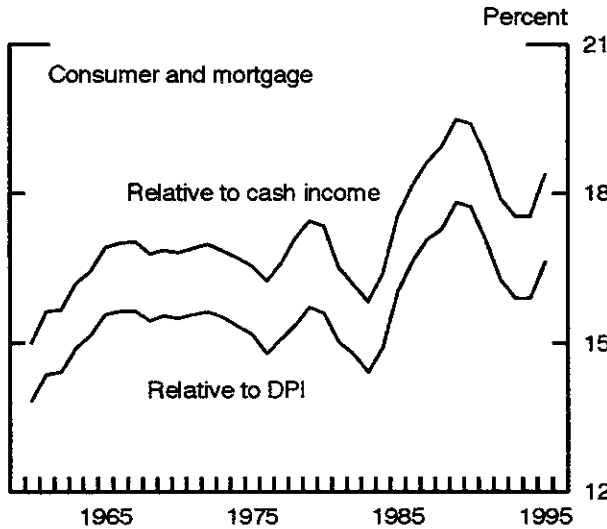


Household Financial Condition

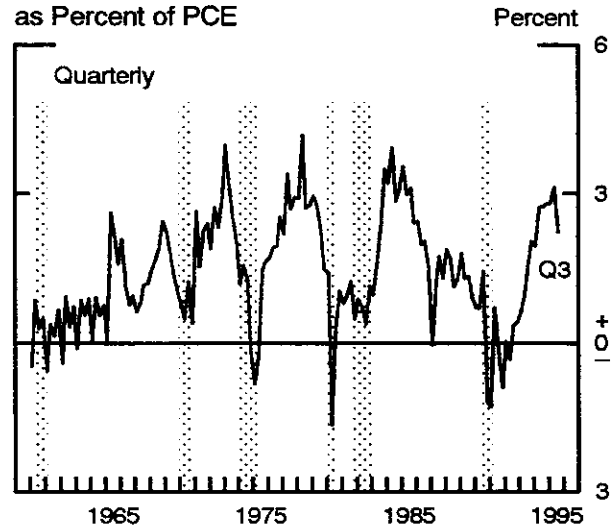
Mortgage and Consumer Debt Relative to Disposable Personal Income



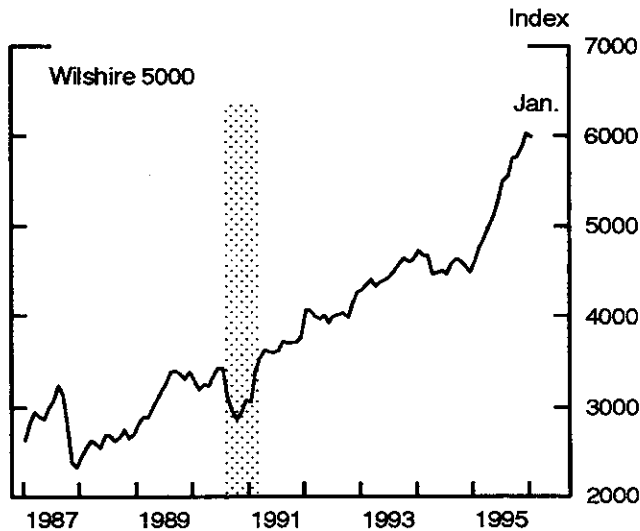
Debt Service



Consumer Credit Flow as Percent of PCE



Stock Market



Net Worth as a Share of Disposable Personal Income

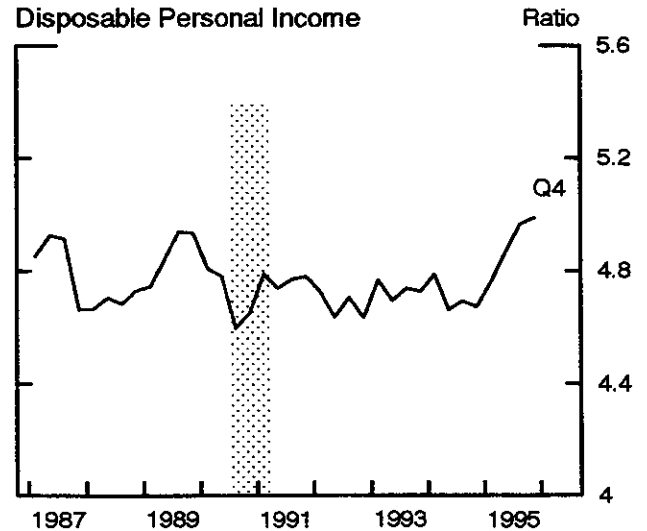
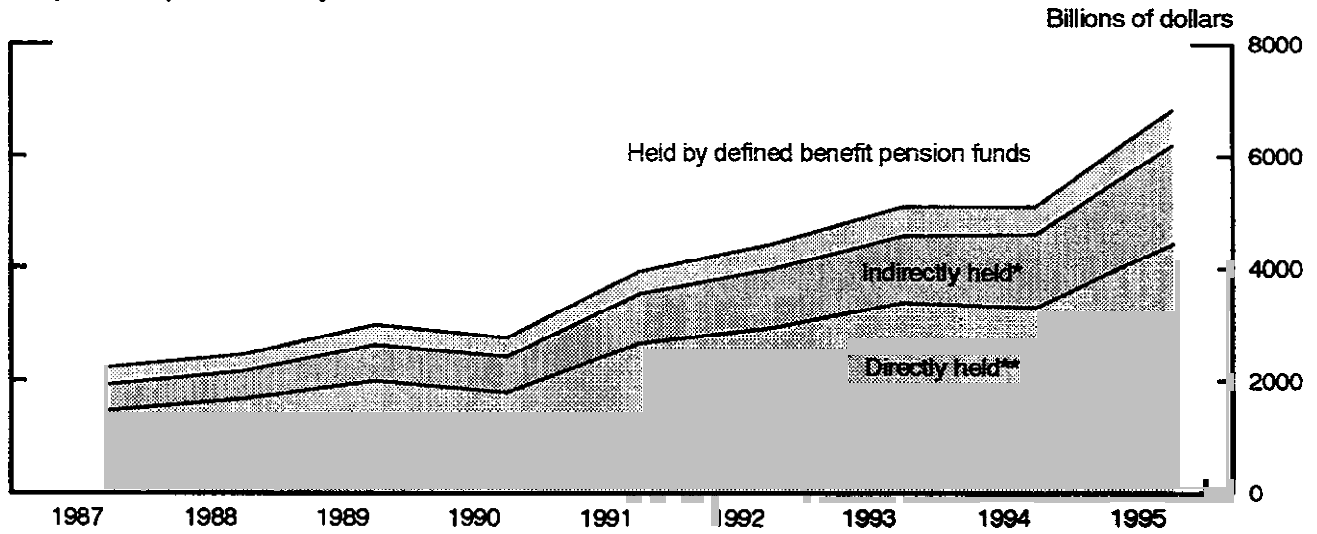


Chart 12

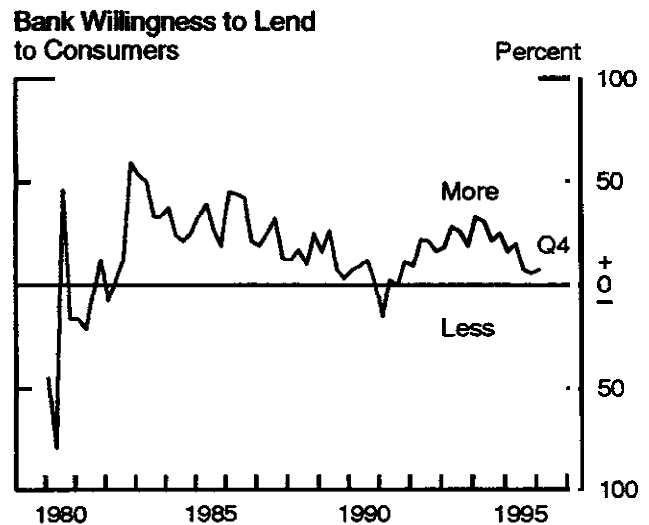
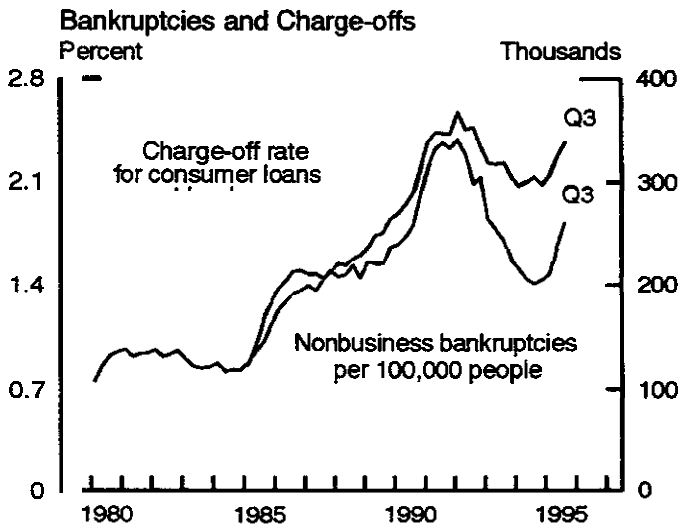
Corporate Equities Held by Households



* Corporate equities held through defined contribution pension plans, variable annuities, IRA/Keoghs, and personal trusts.
 ** Includes corporate equity held by direct household ownership of mutual fund shares.

Distributions of Assets and Debt, by Income in 1992 (Percent of all households)

| Income (1992 dollars) | Percentage of households (1) | Assets (2) | Debt (3) | Median debt payment ratio ¹ (4) | Financial assets greater than debt ² (5) | Percent of families who did <u>not</u> save (6) |
|--------------------------|---------------------------------------|---------------|--------------|--|---|---|
| All households | 100.0 | 100.0 | 100.0 | 15.4 | 37.6 | 42.7 |
| Less than 10,000 | 17.6 | 3.3 | 2.2 | 11.6 | 15.9 | 68.3 |
| 10,000-19,999 | 19.6 | 6.1 | 4.7 | 14.7 | 27.9 | 51.1 |
| 20,000-29,999 | 15.3 | 7.2 | 7.7 | 15.3 | 35.0 | 44.3 |
| 30,000-49,999 | 20.8 | 14.7 | 14.3 | 17.1 | 45.2 | 33.6 |
| 50,000-99,999 | 19.3 | 26.1 | 32.6 | 16.2 | 56.3 | 28.8 |
| 100,000-249,999 | 6.1 | 23.2 | 22.9 | 14.9 | 51.1 | 20.2 |
| 250,000 or more | 1.3 | 19.5 | 10.6 | 6.2 | 46.8 | 10.9 |



Source: Senior Loan Officer Survey

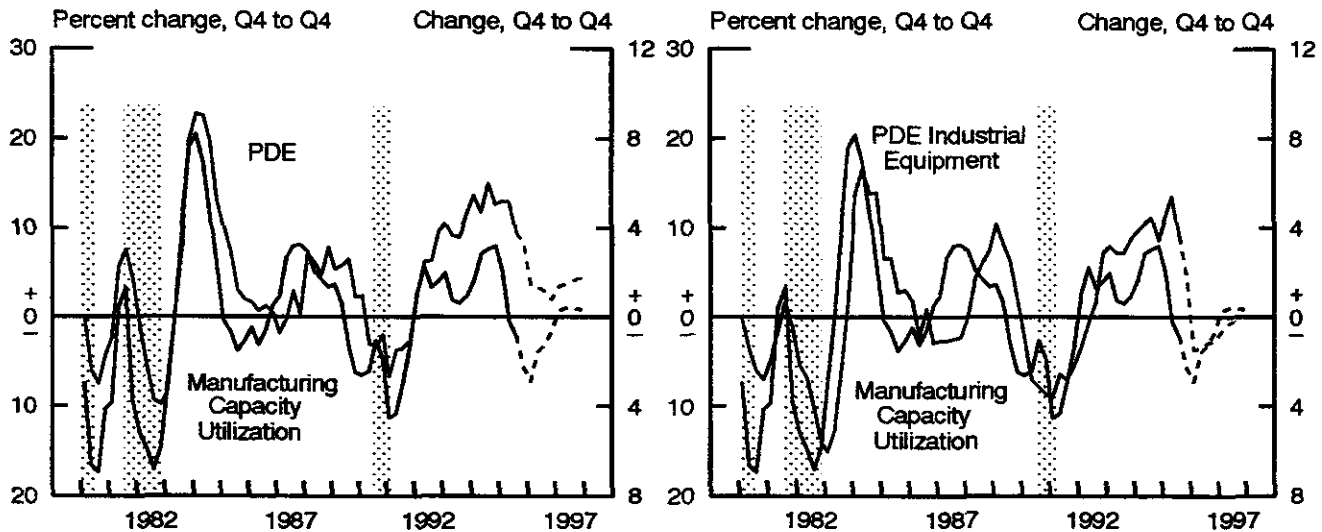
Chart 13

Producers' Durable Equipment

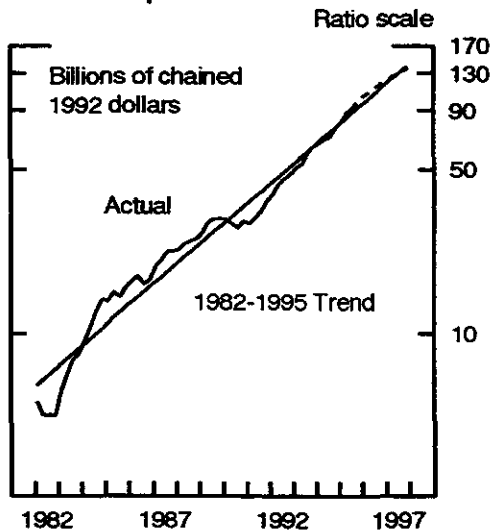
(Chained 1992 dollars, percent change, annual rate)

| | Average growth in expansion | | Projection | | |
|-------------------------|--------------------------------|----------------------|------------|------|------|
| | 1980s ¹ | Current ² | 1995 | 1996 | 1997 |
| 1. PDE | 7.0 | 11.2 | 8.2 | 2.0 | 4.4 |
| 2. Computers | 32.8 | 27.6 | 30.4 | 18.8 | 14.9 |
| 3. Other | 6.0 | 8.8 | 4.3 | -1.7 | 1.6 |
| 4. Industrial equipment | 3.8 | 8.8 | 4.6 | -2.7 | .3 |

1. Average growth rate from cyclical trough in PDE (1982:Q4) to cyclical peak (1989:Q3).
 2. Average growth rate from cyclical trough in PDE (1992:Q1) to 1995:Q3.



PDE - Computers



Selected Forecasts of U.S. Unit PC Sales Growth, 1996

(Percent change)

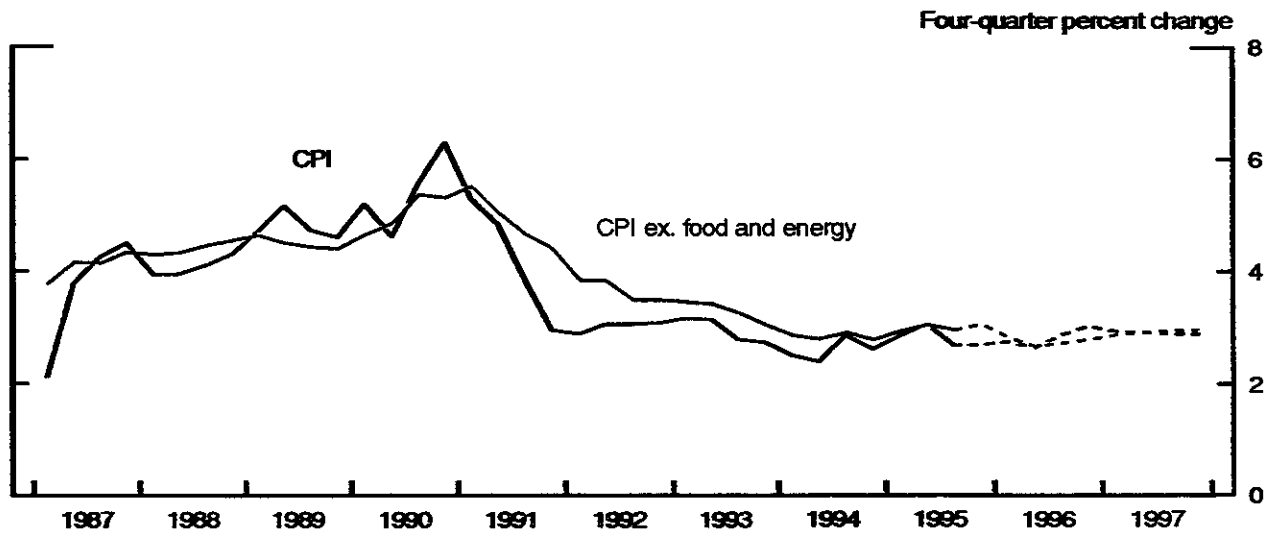
| Source | Forecast* | Comments |
|-------------------|-----------|--|
| IBM | 28 | Some uptick in 1996; still filling the small business market |
| DEC | low 20's | About the same as 1995 |
| Intel | 17-20 | Some upside risks |
| Texas Instruments | 15-20 | Growth a bit slower than in 1995; but still healthy |

* Growth for the entire industry, not individual company.

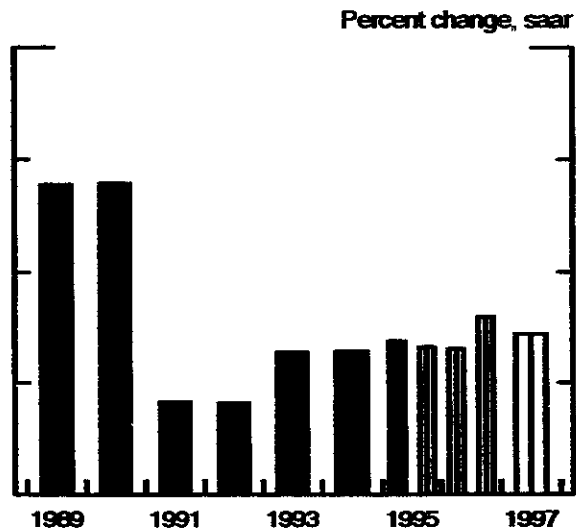
Chart 14

Staff Inflation Outlook

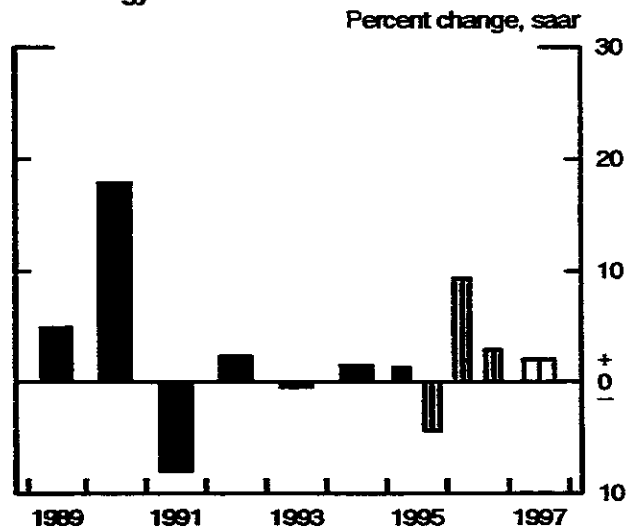
Consumer Price Index



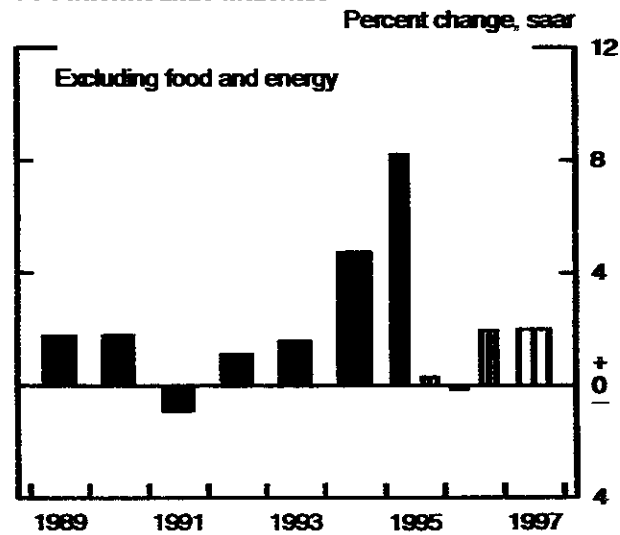
CPI Food



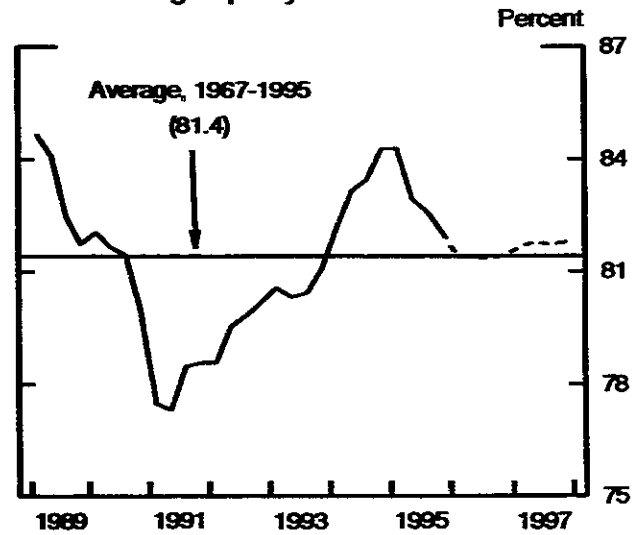
CPI Energy



PPI Intermediate Materials



Manufacturing Capacity Utilization



Potential Output

Supply-side Components of Potential GDP

(Average annual growth rate)

Long-term trends

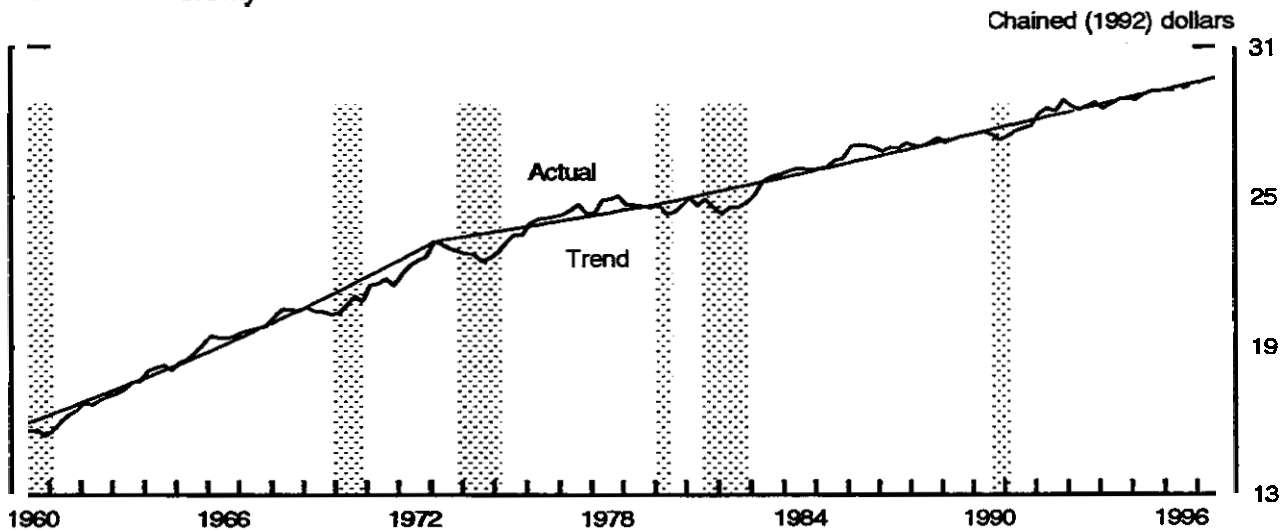
Projection

| | 1960-73 | 1973-79 | 1979-90 | 1990-97 |
|------------------------------------|---------|---------|---------|---------|
| 1. Potential GDP | 4.1 | 3.3 | 2.7 | 1.9 |
| 2. Labor input | 1.2 | 2.0 | 1.6 | 1.0 |
| 3. Labor productivity ¹ | 3.0 | .9 | 1.1 | 1.1 |
| 4. Technical factors ² | -.1 | .4 | .0 | -.2 |

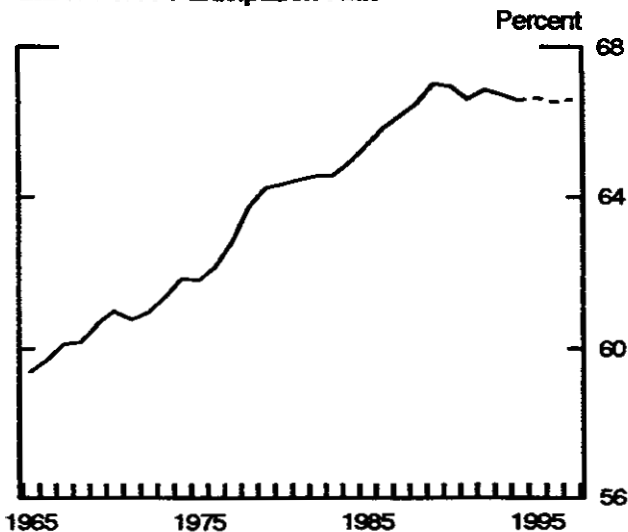
1. Nonfarm business sector.

2. Technical factors include: the ratio of GDP to the output of the nonfarm business sector; the ratio of nonfarm business employment to household employment; and rounding error.

Nonfarm Productivity

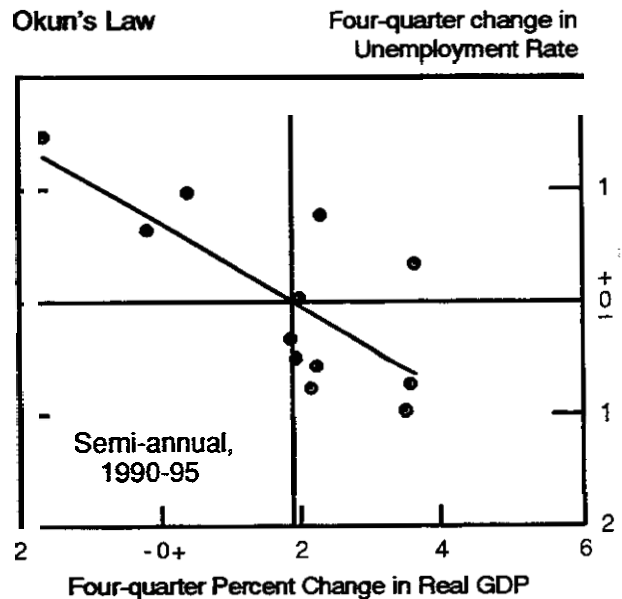


Labor Force Participation Rate*



* Adjusted for CPS revision.

Okun's Law



Has Inflation Been Surprisingly Low?

Revisions to Forecast for 1995

| | CPI ¹ | Unemploy. Rate ² |
|-------------------|------------------|--------------------------------|
| Blue Chip: | | |
| Jan. 95 | 3.3 | 5.6 |
| Jan. 96 | 2.8 | 5.6 |
| Staff: | | |
| Jan. 95 | 2.9 | 5.4 |
| Jan. 96 | 2.7 | 5.6 |

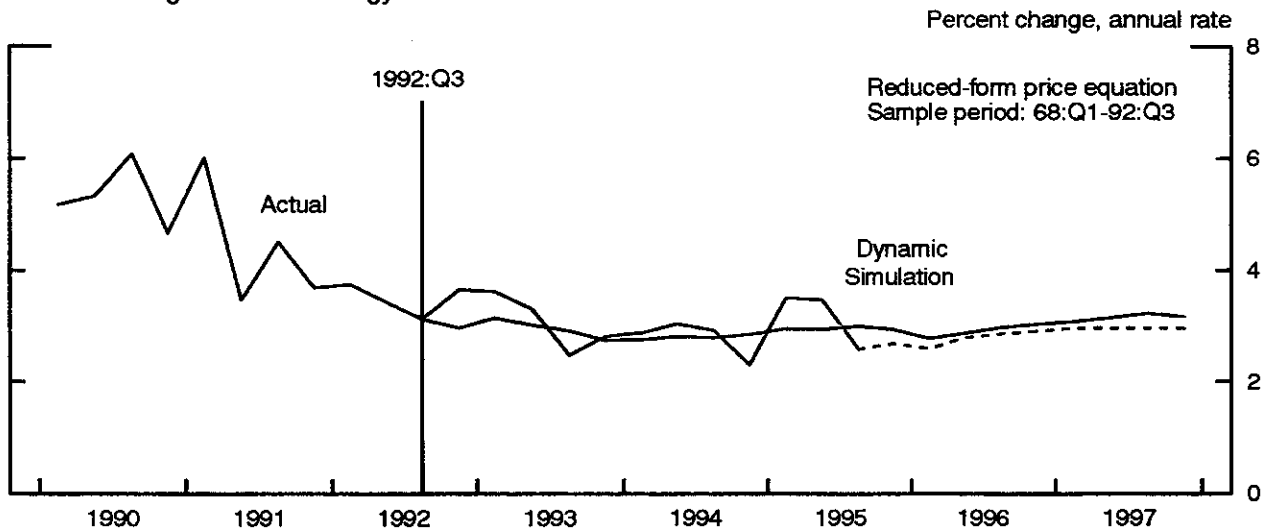
1. Q4 to Q4 percent change.
2. Annual average.

Prices Excluding Food and Energy
12-month percent change*

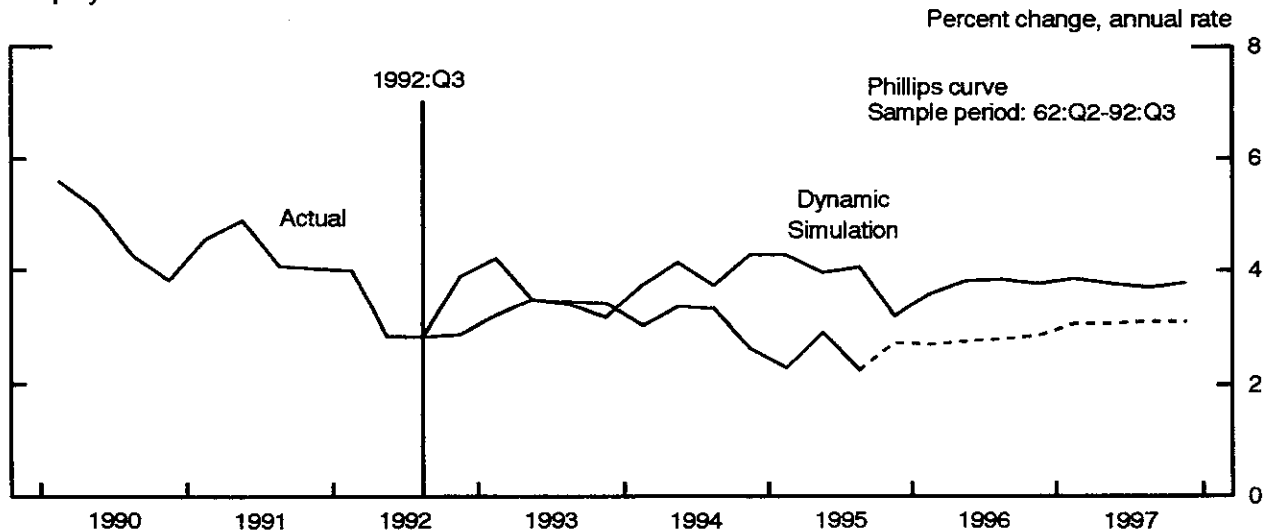
| | PPI | CPI |
|------|-----|-----|
| 1993 | .3 | 3.1 |
| 1994 | 1.6 | 2.8 |
| 1995 | 2.7 | 3.0 |

* November to November.

CPI Excluding Food and Energy



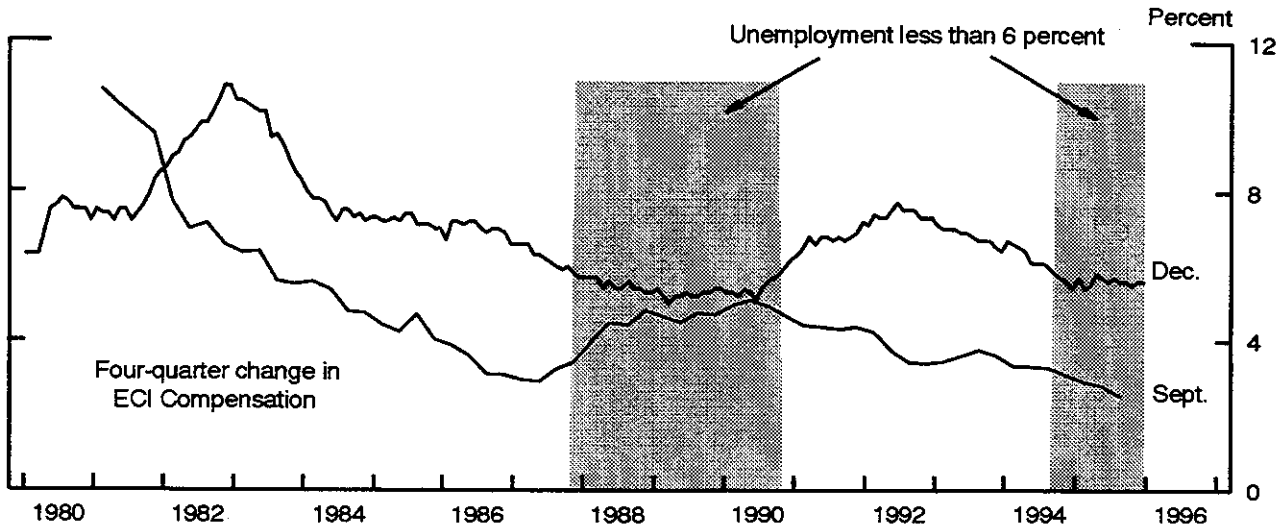
Employment Cost Index*



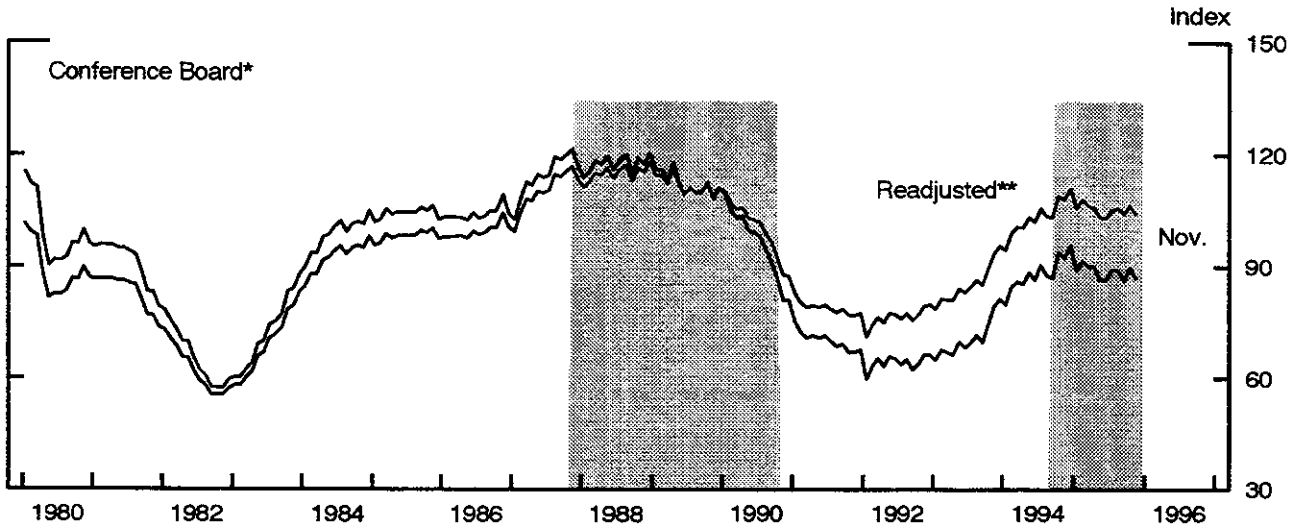
* Spliced with hourly nonfarm business compensation prior to 1980:Q2.

Labor Market Conditions

Civilian Unemployment Rate



Help Wanted Advertising



* Includes Abraham(1987) adjustments.

** Adjusted additionally for trend in employment at personnel supply agencies.

Job Availability

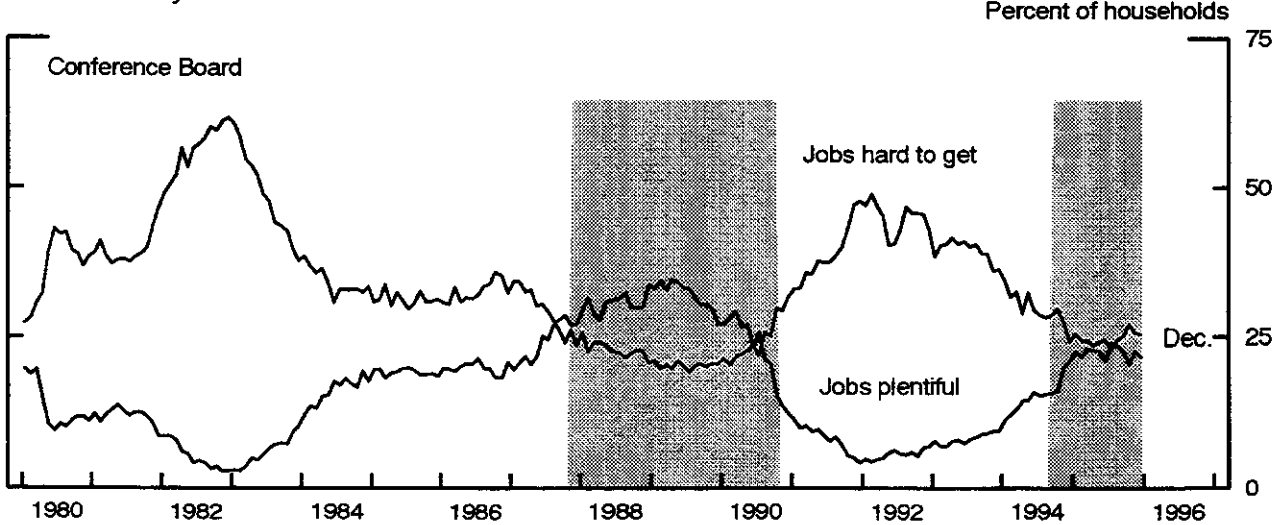
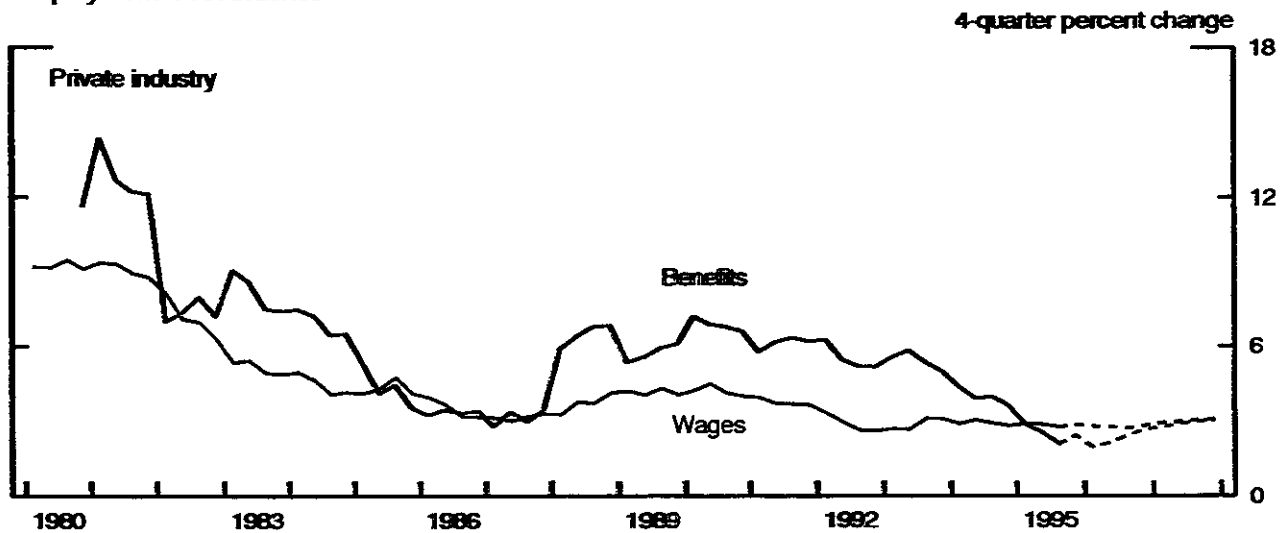


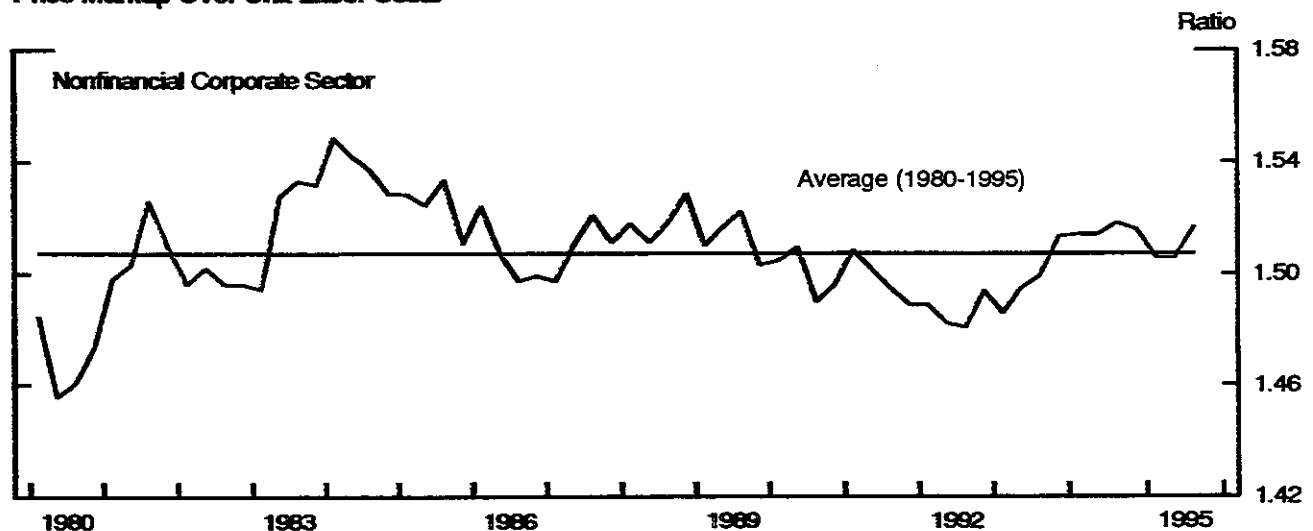
Chart 18

Labor Compensation and the Price Markup

Employment Cost Indexes



Price Markup Over Unit Labor Costs



Forecast Risks: Core CPI for 1996-1997

| | Markup Remains High | Markup Returns to "Normal" |
|---|-------------------------------|----------------------------|
| Growth of Compensation per Hour Remains Low | "Staff Forecast" 3 percent | 2 percent |
| Growth of Compensation per Hour Returns to "Normal" | 4 percent | 3 percent |

ECONOMIC PROJECTIONS FOR 1996

| | FOMC | | |
|--|----------------------------------|----------------------------------|-------|
| | Range | Central Tendency | Staff |
| <hr/> Percent change, Q4 to Q4 <hr/> | | | |
| Nominal GDP | 3.9 to 5.0 | 4.3 to 4.8 | 4.5 |
| previous estimate | $4\frac{5}{8}$ to $5\frac{1}{2}$ | $4\frac{3}{4}$ to $5\frac{3}{8}$ | |
| Real GDP | 1.6 to 2.5 | 2.0 to 2.2 | 1.8 |
| previous estimate | n.a. | n.a. | |
| CPI | 2.5 to 3.0 | 2.7 to 2.9 | 3.0 |
| previous estimate | $2\frac{1}{2}$ to $3\frac{1}{2}$ | $2\frac{7}{8}$ to $3\frac{1}{4}$ | |
| <hr/> Average level, Q4, percent <hr/> | | | |
| Unemployment rate | 5.5 to 6.1 | 5.6 to 5.8 | 5.6 |
| previous estimate | $5\frac{1}{2}$ to $6\frac{1}{4}$ | $5\frac{3}{4}$ to $6\frac{1}{8}$ | |

n.a. Not applicable.

NOTE: Central tendencies constructed by dropping top and bottom three from distribution.